UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION

IN RE:	Case No. 98-31400
SHARON ALLEN TARLTON,	Chapter 7
Debtor.	
SHARON ALLEN TARLTON,	Adversary Proceeding No. 98-3113
Plaintiff,	
vs.	
FIRST CITIZENS BANK,	
Defendant.	

JUDGEMENT ENTERED ON DEC - 4 1998

JUDGEMENT ENTERED ON DEC - - 1998

ORDER GRANTING MOTION TO DISMISS

In this proceeding, Sharon Allen Tarlton, the Chapter 7 debtor ("Tarlton" or "Debtor"), seeks to value and avoid Defendant First Citizens Bank and Trust Company's ("First Citizens") deed of trust on the debtor's real property pursuant to 11 U.S.C. § 506(d). First Citizens asks that this action be dismissed pursuant to Fed. Rule Civ. Pro. 12(b)(6), on the grounds that the Complaint fails to state a claim upon which relief can be granted. A hearing was conducted on October 29, 1998.

FACTS

The Debtor filed a Chapter 7 case with this court on June 10, 1998. Tarlton owns a residence, which according to her Bankruptcy Schedules, has a tax value of $68,700. The property is subject to a first mortgage debt owed to Fleet Mortgage of $71,016. First Citizens holds a second deed of trust on the property, and is owed

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approximately $12,000. On these facts, there is no equity to support First Citizen's second mortgage.[1]

The Debtor received her bankruptcy discharge on October 5, 1998. There being no equity in the property, the real property was not administered by the Chapter 7 Trustee, who filed a Report of No Distribution on July 22, 1998.[2]

The Debtor now seeks to value the property under 11 U.S.C. § 506 and to strip away the second deed of trust of First Citizens. In short, the debtor wants to keep the real estate but continue payments only on the first mortgage. Tarlton contends that First Citizens' debt is an unsecured claim and its lien is void, relying on the wording of 11 U.S.C. § 506(d).

First Citizens objects, arguing that the Supreme Court's decision in Dewsnup v. Timm, 502 U.S. 410, 112 S.Ct. 773, 116 L.Ed.2nd 903 (1992) precludes a Chapter 7 debtor from stripping a lien under Section 506(d). First Citizens also contends that if such a remedy were available, the debtor lacks standing to seek the same.

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[1] This matter is before the Court on a motion to dismiss. As such, the property valuation and payoffs alleged in the Plaintiff's complaint are assumed to be correct.

[2] Technically, that property remains in the bankruptcy estate until the case is closed or the property abandoned. 11 U.S.C. § 554 (1993). Practically, the debtor has possession and control over the property, and both parties have treated the debtor as the owner. The Court will overlook the technical ownership issue.

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LEGAL DISCUSSION

I. Standing.

First Citizens' standing argument is based upon a Ninth Circuit Bankruptcy Appellate Panel decision, In re Laskin, 222 B.R. 872, 874-75 (B.A.P. 9th Cir. 1998). Laskin involved a fact situation identical to that in this case. The Laskins, Chapter 7 debtors, sought to void an unsecured second mortgage lien on their residence under Section 506(d). Both the Bankruptcy Judge and the Bankruptcy Appellate Panel ("BAP") concluded that Dewsnup prohibited such relief. The BAP also held that the debtor lacked standing to bring such a motion. It looked at Section 506(d) which provides that to the extent that a lien securing a claim is not an allowed secured claim, the lien is void. 11 U.S.C. § 506(d). However, the subsection says nothing about who can seek such relief or when. Laskin took this silence to mean that Subsection 506(d) does not really avoid liens, but simply describes the effects of using other Code avoiding powers on a lien. Laskin, 222 B.R. at 874. Because none of those avoiding powers pertain to a Chapter 7 debtor in this situation, Laskin concludes a debtor lacks standing to bring such a motion. Id.

The undersigned has serious doubts about this proposition. The Laskin holding confuses transfers and acts which may be selectively "avoided" under the Code with those that are automatically "void." Liens which impair exemptions (Section 522(f)), statutory liens (Section 545), or preferences (Section 547) *may be avoided* under the Bankruptcy Code. Other actions and transfers are simply *void*,

having no legal effect. In addition to liens under Section 506(d), actions taken in violation of the automatic stay are void. 11 U.S.C. § 362(a). Although the BAP decision suggests otherwise, the Ninth Circuit, like most courts, recognizes a distinction between an avoidable act/transfer under the Bankruptcy Code and one that is void. See, e.g., In re Shamblin, 890 F.2d 123, 125 (9th Cir. 1989) ("Judicial proceedings in violation of [the] automatic stay are void, not avoidable."); accord, In re Stringer, 847 F.2d 549, 551 (9th Cir. 1988) ("Any proceedings in violation of the automatic stay in bankruptcy are void.").

Under the Bankruptcy Code, "void" and "avoid" are separate terms of art. They do not mean the same thing. For example, Section 349(b)(1)(B) states that dismissal of a bankruptcy case reinstates transfers *avoided* under sections 522, 544, 545, 547, 548, 549, or 724. However, in the very next subpart, Section 349 states that dismissal also reinstates a lien *voided* under Section 506(d). 11 U.S.C. § 349(b)(1)(C). Since lien creation is but one type of a transfer, if "void" and "avoid" mean the same thing, Section 349(b)(1)(C) would be rendered meaningless.

Assuming Section 349 means what it says, and dismissal reinstates a lien voided under Section 506(d), it becomes clear that Section 506(d) has its own power and is not dependent upon use of an avoiding power. If Section 349 reinstates a lien "voided" under Section 506(d), then Section 506(d) must have previously affected the lien in some way.

Laskin also does not satisfactorily explain why a Code section must specifically identify a particular party as having standing to do something in order to be effective. Laskin concludes that since Section 506(d) does not state who can use the provision, no one can. However, Section 506 is located in a chapter of the Bankruptcy Code applicable to all types of bankruptcy cases, including Chapter 7. 11 U.S.C. § 103(a). The notion that Congress would enact a statute applicable to all types of bankruptcy, but usable by no one, is a bit hard to accept.

However, these differences of opinion are not crucial to the holding in this case. For whether one calls it a "lack of standing" or instead a "function of substantive law," it seems clear that Dewsnup prohibits a Chapter 7 debtor from using Section 506(d) to strip down a creditor's lien.

II. A Chapter 7 Debtor cannot strip down a creditor's lien on real property under 11 U.S.C. 506(a) & (d), even when that lien claim is entirely unsecured.

A short review of Dewsnup is in order. Factually, Dewsnup and this case are similar. Dewsnup and her husband (now deceased) gave a creditor a lien on two tracts of farmland. After defaulting on the obligation, but before the creditor could foreclose, Dewsnup filed a Chapter 7 bankruptcy case. At the petition date, the creditor was owed $119,000, but the farmland was worth only $39,000. The Chapter 7 Trustee did not try to sell the property. Dewsnup wanted to retain her land, so she brought an action seeking to "avoid" the unsecured portion of the lien ($80,000) pursuant to

Code Sections 506(a) and (d). She would retain the property but pay only the secured part of the debt ($39,000). Dewsnup, 502 U.S. 410, 413.

Dewsnup was attempting what is known in bankruptcy circles as "stripping down" a lien. Prior to this case, lien stripping was seen by many in the bankruptcy area, including the undersigned, as a proper action, and the logical result of a plain reading of Section 506 and its subparts.

Subsection 506(d) states that to the extent a lien secures a claim against the debtor which is not an allowed secured claim, the lien is void, 11 U.S.C. § 506(d). Section 506(a) makes a claim secured by a lien a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property and an unsecured claim as to the rest.

Reading these two subparts together, courts held that a creditor was unsecured as to any excess of the debt over the collateral value. To the extent the lien was unsecured, it was subject to being stripped down. David Gray Carlson, Bifurcation of Undersecured Claims, 70 AM. BANKR. L.J. 1, 5 (1996).

In Dewsnup, the Supreme Court rejected this view, holding that the term "allowed secured claim" in subsection 506(d) does not necessarily mean the same thing as "allowed secured claim" in subsection 506(a). Dewsnup, 502 U.S. at 415. Rather, Justice Blackmun writing for the majority opined that under subsection 506(d), one first asks whether the claim is allowed under Section 502, and second, whether it is secured by a lien. If so, the debt

is an "allowed secured claim," and the creditor's lien stays intact even if the claim exceeds the value of the collateral. Id. at 773.

The Dewsnup holding was sharply criticized at the time it was rendered. As one commentator points out, Justice Blackmun's opinion "stunned the bankruptcy community by choosing to read 506(d) in a most unorthodox manner." Carlson, supra, at 13.

This criticism was not limited to bankruptcy practitioners. Justice Scalia's dissenting opinion in Dewsnup points out in detail the problems associated with defining "allowed secured claim" in this way. According to Scalia, the majority violates principles of statutory construction by ruling that a term contained within a single statute can have two entirely different meanings. Dewsnup, 502 U.S. 420-35. He notes that the majority opinion writes language out of Section 506(d), and creates redundancy in the subsection thereby by violating the canons of statutory construction. Id., at 424. Scalia's view is that the plain meaning rule dictates that the words "allowed secured claim" must be interpreted to mean a claim which is both allowed under section 502 and secured under Section 506(a). Id.

The dissent also points out practical problems in the majority's definition of "allowed secured claim." Because this term appears in several other Code Sections, defining the term to mean simply "an allowed claim for which a lien has been granted," would have unintended and undesirable consequences. For example, if in fact liens pass through Bankruptcy unabated, and a lien creditor is entitled to appreciation in his collateral, then how could you sell

property under Section 363? Wouldn't the lien rise up at a later date to bite a purchaser? Id. at 426.

In recognition of these problems, the Dewsnup majority limited its holding to the facts presented in the case.[3] In a footnote, Justice Blackmon said that the Court makes no holding whether "allowed secured claim" has a different meaning in other Code sections. Dewsnup, 502 U.S. at 417 n.3.

Given its unorthodox reading of the statute, it is clear that Dewsnup is a decision founded more on equity and history than on statutory analysis. Dewsnup, the debtor, was attempting to write down a lien to her benefit without any corresponding advantage to the lien creditor or to other creditors. The effect of this maneuver would be to freeze the value of the creditor's lien at what it was worth on the bankruptcy date -- a depressed value. The creditor would lose the benefit of any increase in value to the property when farm prices rebounded. The Supreme Court thought this practice, if allowed, would deny the creditor one of the rights it had bargained for in obtaining collateral for its debt and would result in an unfair "windfall" to the debtor. Id. at 410.

The majority also considered this result to be at odds with the historical treatment of liens in bankruptcy. Notwithstanding a number of Code Sections to the contrary, the Dewsnup majority

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[3] The Court states: "Hypothetical applications that come to mind and those advanced at oral argument illustrate the difficulty of interpreting the statute in a single opinion that would apply to all possible fact situations. We therefore focus upon the case before us and all other facts to await their legal resolution on a another day. Dewsnup, 502 U.S. at 416-17.

adhered to the tenet that liens pass through bankruptcy unabated. No provision under the Bankruptcy Act had allowed a debtor to write down a lien in the way that Dewsnup proposed. Id. at 418-19. And while under either the Act or the Code, the bankruptcy discharge eliminates a debtor's *in personam* liability for her debts, the Supreme Court saw no reason why a debtor should be able to use bankruptcy to eliminate an *in rem* right like a lien. Id.

With this historical perspective, the Dewsnup majority looked to the wording of Section 506 of the new Bankruptcy Code. If read by its terms, Section 506 would affect a major change in the treatment of secured creditors in bankruptcy cases, particularly undersecured creditors. The changes were so surprising that the Court felt they were unintentional. It considered Section 506 to be ambiguous on the topic of lien stripping.[4] The majority reviewed legislative history, concluded that there was no express intention by Congress to change the practice as it had existed under the Act, and that the old law still applied. Dewsnup, 502 U.S. at 418-19.

As the Justice Scalia and the commentators attest, there are problems with this holding. Not surprisingly, lower courts have taken to heart the Supreme Court's warning that the Dewsnup holding

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[4] Commentators tend to disagree with this view and believe that in passing the Code Congress intended to effect a major "sea-change" between the rights of creditors and debtors. Carlson, supra, at 18 (summarizing the work of Mary Josephine Newborn (Wiggins), Undersecured Creditors in Bankruptcy: Dewsnup, Nobelman, and the Decline of Priority, 25 ARIZ. ST. L.J. 547 (1993)).

is applicable only in its factual setting. The lower courts have been reluctant to extend Dewsnup to other bankruptcy contexts.

For example, even after Dewsnup, courts still hold that stripping down of an undersecured, nonresidential mortgage claim may be accomplished by a Chapter 13 plan. Sapos v. Provident Inst. of Sav. in the Town of Boston, 967 F.2d 918, 921 (3d Cir. 1992); In re Hernandez, 175 B.R. 962 (N.D. Ill. 1993). A chapter 13 plan may "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence." 11 U.S.C. § 1322(b)(2). Based upon Nobelman v. American Savings Bank, 508 U.S. 324, 113 S.Ct. 2106, 124 L.Ed.2d 228 (1993), a decision that came down after Dewsnup, courts look to the Section 506(a) definition of "allowed secured claim" to determine who is the holder of a secured claim, rather than Dewsnup's Section 506(d) definition.

Additionally, under Chapter 13, even residential mortgages can be stripped if the lien is totally unsecured. In re Lam, 211 B.R. 36 (9th Cir. 1997) In re Plouffe, 167 B.R. 198, 200 (Bankr. D. Conn. 1993). These courts have adopted Justice Scalia's view that an unsecured creditor's lien rights are "empty rights from a practical, if not a legal, standpoint." This Court agrees with both theories, in a Chapter 13 context.

However, in a Chapter 7 case after Dewsnup, undersecured claims are not strippable, and few courts have allowed stripping of even a wholly unsecured lien. Those cases permitting the practice include In re Yi, 219 B.R. 394 (E.D. Va. 1998) and In re Howard,

184 B.R. 644 (Bankr. E.D. N.Y. 1995). These courts try to distinguish Dewsnup by following the Chapter 13 practice of looking to Section 506(a) to define an "allowed secured claim," rather than Section 506(d). These courts hold that if there is no equity in the collateral to support the lien, then the creditor's claim is wholly unsecured, notwithstanding its paper mortgage. Such a lien can be stripped away from the debtor's property. Yi, 219 B.R. at 397.

The contrary view is represented by the Laskin decision, and the case of In re Madjeric, 157 B.R. 499 (D. Me. 1993). These courts hold that Dewsnup is controlling and under principles of *stare decisis*, a Chapter 7 debtor cannot strip an unsecured lien. Madjeric, 157 B.R. at 499; Laskin, 222 B.R. at 875.

While the logic of Yi is intellectually appealing, that view was rejected in Dewsnup. The only factual distinction between Dewsnup and Yi or the present case, is that some equity supported the lien on Dewsnup's property, while in these other cases there is none. Dewsnup, Yi and this case were brought under Section 506(d). Therefore, the reasoning which caused the Supreme Court to rule in favor of the creditor in Dewsnup applies equally in these cases: the principle that liens pass through bankruptcy unaffected; that the mortgagees bargained for a lien that would stay with the property until foreclosure; and that appreciation goes to the lender. Whether there is some equity or no equity in the collateral seems irrelevant.

Moreover, it is apparent that the Supreme Court meant for the Dewsnup holding to apply to entirely unsecured mortgages. Scalia's dissent alerted the Court to the prospect of how its ruling would affect unsecured mortgages in Chapter 7:

> [T]he practical consequences of [this] interpretation would be absurd. **A secured creditor holding a lien on property that is completely worthless would not face lien avoidance under Section 506(d), even if the claim secured by that lien were disallowed entirely.** The same would be true of a lien on property that has some value but is obviously inadequate to cover all of the disallowed claim. Dewsnup, 502 U.S. at 426 (emphasis added).

If the Supreme Court meant to distinguish unsecured from undersecured debts, it would have so stated. It did not.

Courts and commentators may disagree with the logic of Dewsnup. However, until such time as Congress elects to change the Code, that decision controls. When considering a Chapter 7 debtor's effort to strip down a lien under Section 506(d), you look first at whether the claim is allowed under Section 502(d), and then at whether it is secured by a lien. If both criteria are met, the claim is an allowed secured claim.

Clearly, First Citizen's claim is secured by a lien -- a mortgage. The claim is allowable. Under Dewsnup, the claim may not be stripped.

THEREFORE, the Defendant's Motion to Dismiss is **ALLOWED**. This adversary proceeding is hereby **DISMISSED WITH PREJUDICE**.

This the 30 day of December, 1998.

SO ORDERED.

J. Craig Whitley
United States Bankruptcy Judge